NALSAR

Fees for Technical Services (FTS) & Make Available

CA Lakshmana Kumar Devara

September 2024

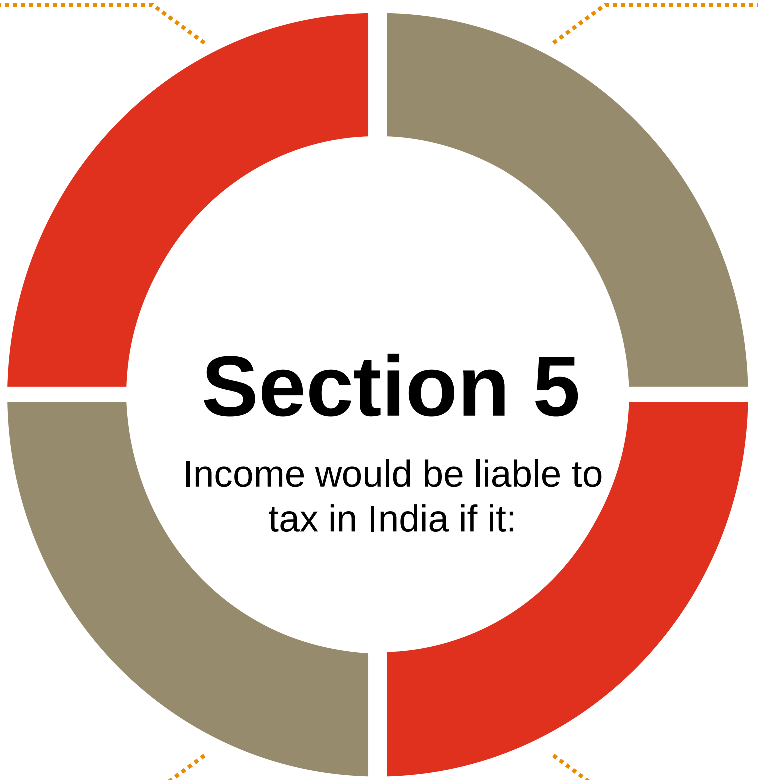
Contents

Section

1

Concept of FTS under IT Act and DTAA

Background



Accrues or arises outside India

- Relevant for ROR
- Relevant for RNOR only in situations where the business controlled in or profession set up in India

Received or deemed to be received in India

Accrues or arises in India

Deemed to Accrue or arise in India (Section 9)

- Includes Royalty - Sec 9(1)(vi)
- Includes FTS - Sec 9(1)(vii)
- Regardless of where the income generating activity is performed (i.e., whether in India or not)

Taxability of FTS under IT Act - Section 9(1)(vii)

(vii) income by way of fees for technical services payable by -

(a) the Government; or

(b) a person who is a resident, except where the fees are payable in respect of services utilised in a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India ; or

(c) a person who is a non-resident, where the fees are payable in respect of services utilised in a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India:

Taxability of FTS under IT Act - Services ‘Rendered’ and ‘Utilized’

Ishikawajma Harima Heavy Industries Ltd (288 ITR 408) (2007) (SC)

- It was held that, for any income to be taxable in India under the deeming fiction of Section 9, there must be sufficient territorial nexus between such income and the territory of India
- To establish such territorial nexus services have to be ‘rendered’ and ‘utilised’ in India

Amendment

*“S.9(2) – Explanation. - For the removal of doubts, it is hereby declared that for the purposes of this section, income of a non- resident shall be deemed to accrue or arise in India under….. clause (vii) of sub-section (1) and shall be included in the total income of the non- resident, **whether or not**, -*

(i) the non-resident has a residence or place of business or business connection in India; or”

Jindal Thermal Power Co. Ltd. (321 ITR 31) (2010) (Karnataka HC)

- It was held that the explanation, in its present form, does not do away with the requirement of ‘rendering’ of services in India. Observation in Ishikawajima would still hold good.

Amendment

(ii) the non-resident has rendered services in India

Taxability of FTS under IT Act - Section 9(1)(vii)(b) constitutional validity

(vii) income by way of fees for technical services payable by—

(a) …..

(b) a person who is a <u>resident</u>, except

– where the fees are payable in respect of services utilised in a business or profession carried on by such person outside India (or)

– for the purposes of making or earning any income from any source outside India ; or

(c) …..

GVK Industries Ltd vs. ITO ([2015] 54 taxmann.com 347 (SC)

- Incorporated in Andhra Pradesh, GVK Industries Ltd, was awarded to operate a natural gas project in East Godavari District.
- For raising finance, the petitioner appointed ABB- Projects & Trade Finance International Ltd., located in Zurich, Switzerland i.e., for Project finance consultancy (assessing of lending alternatives, new methods for local and foreign borrowings, loan negotiations, structuring of documents etc.)
- The question was whether the payment for these services, provided outside India, would be taxable in India.
- The Court affirmed that if such services are used within India (even if rendered outside), it would attract section 9(1)(vii)(b).
- India has the right to tax transactions involving non-residents if there is a clear and substantial connection to India. The Court also reaffirmed that the territorial jurisdiction of Indian law can extend beyond its borders, provided there is a reasonable nexus to Indian interests.

Taxability of FTS under IT Act - Section 9(1)(vii)(b) exclusion (1/2)

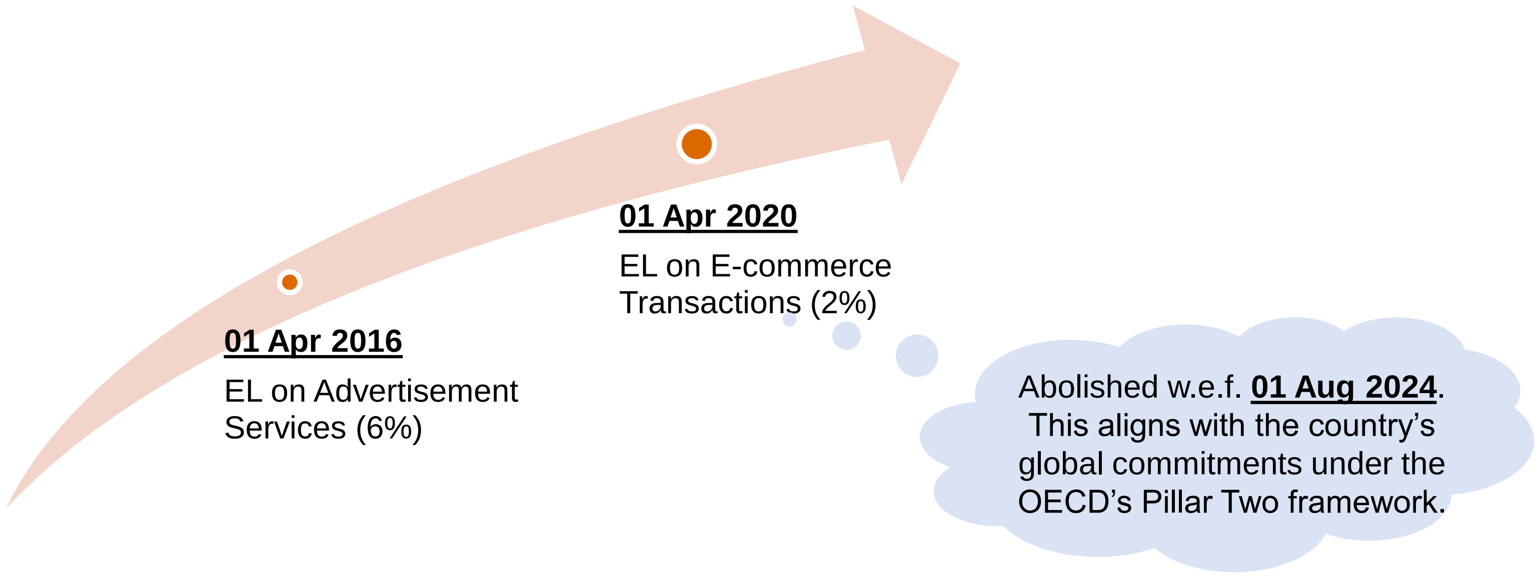
(vii) income by way of fees for technical services payable by—

(a) …..

(b) a person who is a resident, except

- where the fees are payable in respect of services utilised in a business or profession carried on by such person outside India (or)
- for the purposes of making or earning any income from any source outside India ; or

(c) …..



Taxability of FTS under IT Act - Section 9(1)(vii)(b) exclusion (2/2)

#	Judicial Precedence	Issue under consideration	Principles laid down
1	ITO vs. Bajaj Hindustan Ltd. (2011) (13 taxmann.com 13) (Mumbai Tribunal)	Payment made to a Brazilian company to advice and assist in acquisition of sugar mills and distilleries in Brazil	• Assessee was contemplating to create a source for earning income outside India, though source of income had not yet come into existence, assessee would still get benefit of exceptional clause (b) of section 9(1)(vii)
2	CIT vs. Havells India Ltd. (352 ITR 376)(Delhi HC)	Taxability of testing and certification services paid to a US company for the export of a product to US.	• HC distinguished 'Source of Income' vs. 'Source of Monies received' • Export contracts are concluded in India
3	Titan Industries Ltd. vs. ITO (11 SOT 206)(Bangalore Tribunal)	Payments to a vendor for registering a Patent in Hongkong	• Since patent was registered outside country for making an income from a source outside country, amount paid to the vendor was covered by the exclusionary clause
4	DIT vs. Lufthansa Cargo India Pvt Ltd. (2015) 60 taxmann.com 187 (Delhi HC)	Payments made to a German company for overhaul and maintenance of Aircrafts (given on wet lease to foreign airline companies on international routes only)	• Since operations were abroad and expenses towards maintenance and repairs were for purpose of earning abroad, payment made by assessee for carrying out overhaul repair fell within exclusionary clause

Taxability of FTS under IT Act - Section 9(1)(vii)(b) exclusion (2/2)

#	Judicial Precedence	Issue under consideration	Principles laid down
5	CIT vs Aktiengesellschaft Kuhnle Kopp and Kausch W. Germany by BHEL (2002) (125 Taxman 928) (Madras HC)	Royalty paid in relation to export sales	• Since the source for royalty is from the source situate outside India, the royalty paid on export sales is not taxable within the meaning of section 9(1)(vi).
6	Suzlon Energy Ltd. vs. ACIT (2015) (64 taxmann.com 114) (Ahmedabad Tribunal)	Interest on FCCBs issued by Suzlon to bond-holders outside India	• Since the FCCBs are issued to non-residents and the proceeds are utilized for acquisition of foreign subsidiaries, the remittances squarely fell under exclusion clause of sub-section (1)(v)(b) of section 9

Taxability of FTS under IT Act - Definitions

Definition under IT Act

Section 9(1)(vii) Explanation 2

- *"For the purposes of this clause, "fees for technical services" means any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel) but does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head 'Salaries'".*

Definition under DTAA (UN Model)

Article 12A

- 3. *The term "fees for technical services" as used in this Article means any payment in consideration for any service of a managerial, technical or consultancy nature, unless the payment is made:*

  (a) to an employee of the person making the payment;

  (b) for teaching in an educational institution or for teaching by an educational institution; or

  (c) by an individual for services for the personal use of an individual.

Taxability of FTS under IT Act - Definitions

- The terms “managerial”, “technical” and “consultancy” have not been specifically defined in the IT Act. The Apex Court in GVK Industries Ltd [2015] 371 ITR 453 (SC) held that general and common usage of the said words has to be understood in common parlance.

Managerial

The term managerial services, ordinarily means handling management and its affairs. As per the concise oxford dictionary, the term managerial services means rendering of services which involves controlling, directing, managing or administering a business or part of a business or any other thing - Endemol South Africa (Proprietary) Ltd. v DCIT (2018) (98 taxmann.com 227) (Mum Trib.)

Technical

- Technical services' like 'Managerial and Consultancy service' would denote seeking of services to cater to the special needs of the consumer/user, as may be felt necessary and the making of the same available by the service provider. It is the above feature that would distinguish/identify a service provided from a facility offered. - CIT v Kotak Securities Ltd. (2016) 383 ITR 1 (SC).

Consultancy

- The word "consultant" is a derivative of the word "consult" which entails deliberations, consideration, conferring with someone, conferring about or upon a matter. Service of consultancy necessarily entails human intervention. The consultant, who provides the consultancy service, has to be a human being. A machine cannot be regarded as a consultant. - CIT v. Bharti Cellular Ltd. [2009] 319 ITR 139 (Delhi HC).

Taxability of FTS under IT Act - Prerequisites for ‘Technical service’

- Human Intervention - Rule of ‘Noscitur a sociis’ to be applied since ‘Technical’ comes in between ‘Managerial’ and ‘Consultancy’ services

  - CIT v Bharti Cellular Ltd. (2011) (330 ITR 239) (SC)

- Standard facility vs. Provision of service

  - Skycell Communications Ltd v. Dy. CIT (2001) (119 Taxman 496/251 ITR 53) (Mad.)

Taxability of FTS under IT Act - Rate of Tax u/s 115A

These rates can be compared with the beneficial provisions under DTAA

FA 2013

- Tax rate u/s 115A on royalty and FTS was increased to **25%**

FA 2015

- Tax rate u/s 115A on royalty and FTS was reduced to **10%**

FA 2023

- Tax rate u/s 115A on royalty and FTS was increased to **20%**

Taxability of FTS - Various services

Select services and Taxability as FTS

- Sourcing services in relation to goods
- Provision of Bandwidth or Internet services
- Freight and Logistics, loading and unloading services
- Marketing and export sale support services
- Standard cellular telephone service, Interconnect charges paid to telecom service providers

Taxability of FTS - Under DTAA (UN MC)

Article and Para Reference	UN Model
Article 12A(1)	• Distribution of rights between Resident and Source contracting states
Article 12A(2)	• Ceiling of rate for Source state taxation
Article 12A(3)	• Defines the term ‘FTS’
Article 12A(4)	• FTS article would not apply if FTS arise through a PE or performs IPS from a fixed base and such FTS is effectively connected with the said PE of Fixed base of Non-residents in the source state, in which case Article 7 or 14 would apply
Article 12A(5)	• Arising of FTS in source state when the payer is a resident (or) a PE in source state and expenditure is borne by the PE
Article 12A(6)	• Adjustments to related party transactions i.e., excess payments over the ALP shall be taxable as per the domestic tax laws

Points for consideration:

- ✓ Beneficial ownership as provided under the respective DTAA
- ✓ Benefit of MFN (if provided under the DTAA)
- ✓ Satisfaction of PPT

Taxability of FTS vis-à-vis IPS

- IPS Article covers income derived in respect of professional services or other independent activities
- "Professional services" is generally defined to include independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, surgeons, lawyers, engineers, architects, dentists and accountants
- FTS provisions under treaty specifically excludes services covered under IPS
- Where IPS is rendered from a PE and services are effectively connected, the said income would be chargeable as Business Income

Generally applicable when the service provider is Individual

Section

2

Concept of ‘Make Available’

Concept of ‘Make Available’

- Memorandum of Understanding (MOU) dated 15 May 1989 signed between the India and USA explains the meaning of ‘Make Available’ as under:

  “Generally speaking, technology will be considered “made available” when the person acquiring the service is enabled to apply the technology. The fact that the provision of the service may require technical input by the person providing the service does not per se mean that technical knowledge, skills, etc., are made available to the person purchasing the service, within the meaning of paragraph 4(b).”

- The service recipient is able to make use of the technical knowledge etc. by himself in his business or for his own benefit <u>without recourse to the service provider</u> in future.

Taxability of FTS - Wordings in various DTAA

Type of FTS clause	**DTAA with India**
Similar to FTS under IT Act	Belgium, Cyprus, Denmark, France, Germany, Ireland, Mauritius (from 2017), Sweden and Swiss confederation etc.
Similar to FTS under IT Act (No Managerial clause)	Spain
Make Available	Australia (included in Royalty clause), Singapore
Make Available (no Managerial clause)	Canada, USA, UK and Netherlands
No FTS clause	UAE, Thailand, Philippines, Greece and Brazil etc.,

Impact of MFN clause under various DTAAs

Concept of ‘Make Available’ - Intragroup charges

- Aircom International Ltd. (Now known as TEOCO) is a company incorporated in UK.
- Aircom International India Private Limited (‘Aircom India’) is a wholly owned subsidiary of Aircom UK and is engaged in business of software solutions and consultancy business in the area of telecommunications.
- The Applicant entered into a Management Service Agreement (“MSA”) with its subsidiaries including Aircom India for providing Management Support Services. Applicant approached the AAR (Refer AAR No. 1329 of 2012 dated 04 Feb 2021)

➢ General management support services

➢ Group-led sales, marketing and business development services

➢ General Treasury and financial management advice and services

➢ Legal services

➢ Human Resource Services

➢ Information Technology (IT) services

  - *Wide area network, Server management, Exchange systems, Help desk; and*
  - *Direct technical advice, support and management including implementation.*

Only specific IT services were considered to qualify ‘Make Available’ criteria

Aircom - AAR

Section

3

Concept of ‘MFN’

Concept of MFN

- Source country intends to provide same tax treatment to two non-resident taxpayers
- It is a treatment which is extended by a Country (say A) to another Country (say B) which is not less favorable than the treatment extended by A to a Third Country (say C)
- Generally MFN is contained in the Protocol or exchange of notes

Treaties with which India has MFN

- India - Belgium
- India - Bulgaria
- India - Chile
- India - Finland
- India - France
- India - Hungary
- India - Nepal
- India - Netherlands
- India - Philippines
- India - Russia
- India - Spain
- India - Sweden
- India - Swiss (Subject to negotiation)

Concept of MFN - A Contentious Issue

Success Fees For arranging loans held FTS ([2015] 54 taxmann.com 347 (SC))

- **MFN under India-Swiss Confederation for Articles 10,11 and 12:**

  "4. If after the signature of the Protocol of 16th February, 2000 under any Convention, Agreement or Protocol between India and a third State which is a member of the OECD India should limit its taxation at source on dividends, interest, royalties or fees for technical services to a rate lower or a scope more restricted than the rate or scope provided for in this Agreement on the said items of income, then, <u>Switzerland and India shall enter into negotiations</u> without undue delay in order to provide the same treatment to Switzerland as that provided to the third State."

- **MFN under India - Netherlands Treaty for Articles 10,11 and 12 (Protocol dated 30th July, 1988:**

  "2. If after the signature of this convention under any Convention or Agreement between India and a third State which is a member of the OECD India should limit its taxation at source on dividends, interests, royalties, fees for technical services or payments for the use of equipment to a rate lower or a scope more restricted than the rate or scope provided for in this Convention on the said items of income, then as from the date on which the relevant Indian Convention or Agreement enters into force the same rate or scope as provided for in that Convention or Agreement on the said items of income shall also apply under this Convention."

- **MFN under India - France Treaty for Articles 10,11 and 12 (Paragraph 7 of the Protocol dated 29th September, 1992):**

  "7. In respect of articles 11 (Dividends), 12 (Interest) and 13 (Royalties, fees for technical services and payments for the use of equipment), if under any Convention, Agreement or Protocol signed after 1-9-1989, between India and a third State which is a member of the OECD, India limits its taxation at source on dividends, interest, royalties, fees for technical services or payments for the use of equipment to a rate lower or a scope more restricted than the rate of scope provided for in this Convention on the said items of income, the same rate or scope as provided for in that Convention, Agreement or Protocol on the said items income shall also apply under this Convention, with effect from the date on which the present Convention or the relevant Indian Convention, Agreement or Protocol enters into force, whichever enters into force later."

Concept of MFN - A Contentious Issue

- Amendment to the India - Netherlands Treaty vide Notification No. S.O. 693(E), dated 30-8-1999

AND WHEREAS in the Convention between India and Germany which entered into force on October 26, 1996, the Convention between India and Sweden which entered into force on December 25, 1997, the Convention between India and the Swiss Confederation which entered into force on October 19, 1994, and the Convention between India and the United States of America which entered into force on December 18, 1990, which states are members of the Organisation for Economic Cooperation and Development, the Government of India, has limited the taxation at source on dividends, interest, royalties, fees for technical services and payments for the use of equipment to a rate lower or a scope more restricted than that provided in the Convention between India and the Netherlands on the said items of income;

NOW, THEREFORE, in exercise of the powers conferred by section 90 of the Income-tax Act, 1961 (43 of 1961), the Central Government hereby directs that the following modifications shall be made in the Convention notified by the said notification which are necessary for implementing the aforesaid Convention between India and the Netherlands, namely:

……

With effect from April 1, 1997, for the existing paragraph 2 of article 10 relating to dividends, the following paragraph shall be read :

"2. However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the recipient is the beneficial owner of the dividends, the tax so charged shall not exceed 10 per cent of the gross amount of the dividends."

Concept of MFN - A Contentious Issue

- <u>Amendment to the India - France Treaty vide Notification No. S.O. 650(E), dated 10-7-2000</u>

“And whereas in the Convention between India and Germany which entered into force on the 26th October, 1996, and the Convention between India and the United States of America which entered into force on the 18th December, 1990, which States are members of the Organisation for Economic Co-operation and Development, the Government of India has limited the taxation at source on dividends, interest, royalties, fees for technical services and payments for the use of equipment to a rate lower or a scope more restricted than that provided in the Convention between India and France on the said items of income ;

Now, therefore, in exercise of the powers conferred under section 90 of the Income-tax Act, 1961 (43 of 1961), the Central Government hereby directs that the following modifications shall be made in the Convention notified by the said notification which are necessary for implementing the aforesaid Convention between India and France, namely:

……

……

V. With effect from the 1st April, 1997, for paragraph 2 of article 13 relating to "Royalties and fees for technical services and payments for the use of equipment", referred to in paragraph IV above, the following paragraph shall be read :

"2. However, such royalties and fees and payments may also be taxed in the Contracting State in which they arise and according to the laws of that Contracting State, but if the recipient is the beneficial owner of these categories of income, the tax so charged shall not exceed 10 per cent of the gross amount of such royalties, fees and payments."

Concept of MFN - Impact of SC Ruling in the case of Nestle SA

- Supreme Court has given a ruling in Nestle SA (155 Taxmann.com 384) (2023)

Steria India	whether the restrictive definition pertaining to FTS as contained in India-UK DTAA due to “make available” condition can be borrowed and read into India-France DTAA by virtue of MFN clause
Concentrix Services Netherlands BV and Optum Global Solutions International BV:	India-Netherlands DTAA prescribed a withholding rate of 10% on dividends received. Subsequently, India entered into treaty with Slovenia which prescribed a lower withholding rate of 5% on dividends. After entering into treaty with India, Slovenia became member of OECD. The Dutch entities borrowed MFN clause to claim benefit of 5%
Nestle SA	India-Swiss DTAA prescribed a withholding rate of 10% on dividends received. Subsequently, India entered into treaty with Lithuania which prescribed a lower withholding rate of 5% on dividends. After entering into treaty with India, Lithuania became member of OECD. The Dutch entities borrowed MFN clause to claim benefit of 5%

Concept of MFN - Impact of SC Ruling in the case of Nestle SA

- Principles laid down by the Apex Court:
  - **Mandatory to notify MFN**: India entering into a DTAA and Protocol with another state does not automatically confer enforceability before the Indian Courts. The enforceability of the said DTAAs and Protocols arise only after a notification is issued by the Central Government in exercise of Section 90(1) of the IT Act.
  - Thus, If the preferential treatment accorded by India in a DTAA with a third state is to be claimed by virtue of MFN clause contained in any other treaty, a separate notification must be issued by the Indian Government.
  - **Practice followed:** The use of the varied language in India - Swiss tax treaty, where both the countries agreed to give the benefit of MFN for rate and scope (based on negotiations) has been disregarded by the Apex Court in light of the practice followed by India for Netherlands and France treaties i.e., issuance of separate notifications to give effect to MFN clauses
  - **Relevant date**: The benefits of the MFN clause can be extended only if the third state is a member of the OECD on the date on which the DTAA with the third state was entered into. The interpretation of the expression “is” significance present.

Thus, the principles laid down by CBDT under Circular 3 of 2022 were upheld

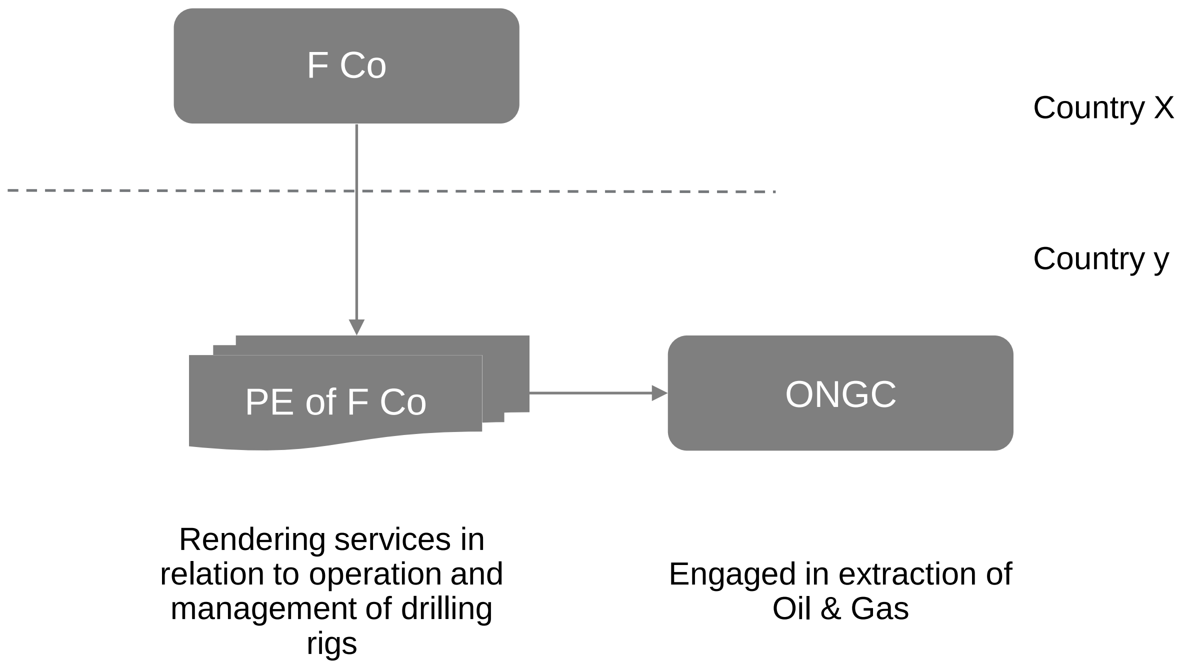
On August 6, 2024, the Supreme Court of India dismissed a review petition filed by taxpayers. The court ruled that there were no grounds for review and that the petition was dismissed.

Section 4

Case Studies

Case study 1 - Whether services w.r.t Mining and Oil exploration contracts are FTS

- Whether the payments made by ONGC for providing various services in connection with prospecting, extraction or production of mineral oil, would be assessed as FTS under section 9(1)(vii) of the IT Act?
- Section 44BB vs. Section 9(1)(vii)

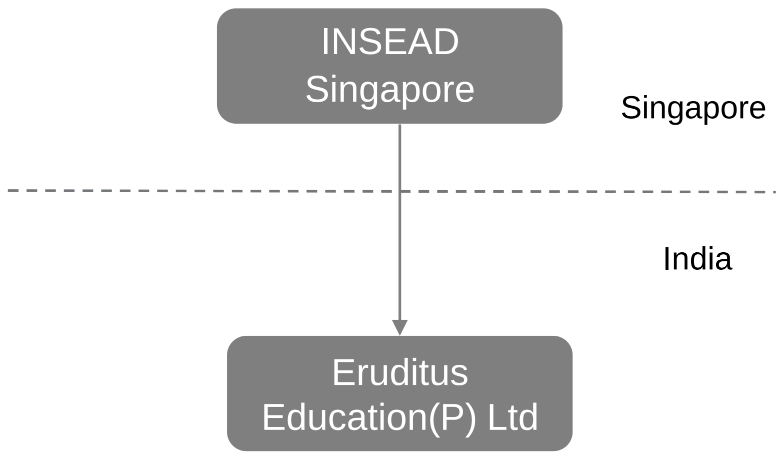


ONGC - SC Judgement

Case study 2 - Payments to Educational Institutions

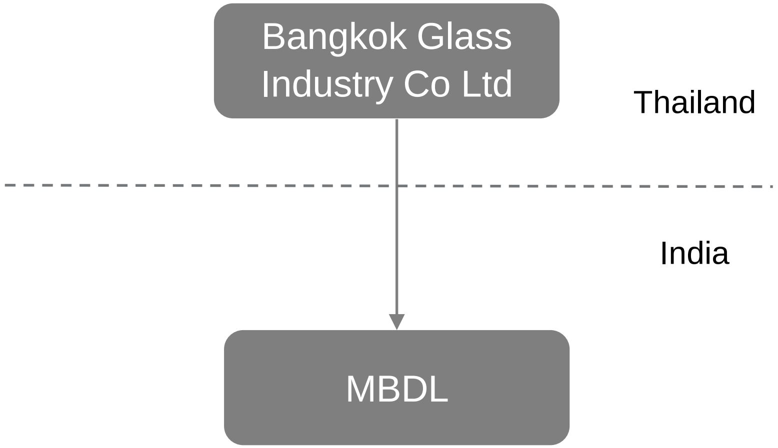
- The Indian company is engaged in the business of providing high quality executive education programmes to Indian corporate and other participants.
- It entered into a Programme Partnership Agreement (PPA) with INSEAD, a Singaporean company which is in the business of providing various management education programmes globally.
- As per the PPA, INSEAD is obliged to conduct teaching intervention as per the agreed terms while the applicant, shall assist in the marketing, organizing, managing and facilitating to conduct the programme.
- The Indian company shall compensate INSEAD for the cost involved in teaching the entire programme and the other incidental expenses.
- Whether such payment would construe FTS or Business Income ?

#	*Description*	*Total number of days*
1.	Teaching at INSEAD, Singapore	11 days
2.	Teaching at INSEAD, France	5 days
3.	Teaching by INSEAD faculty in India	6 days
4.	Teaching through telepresence in Singapore	8 days



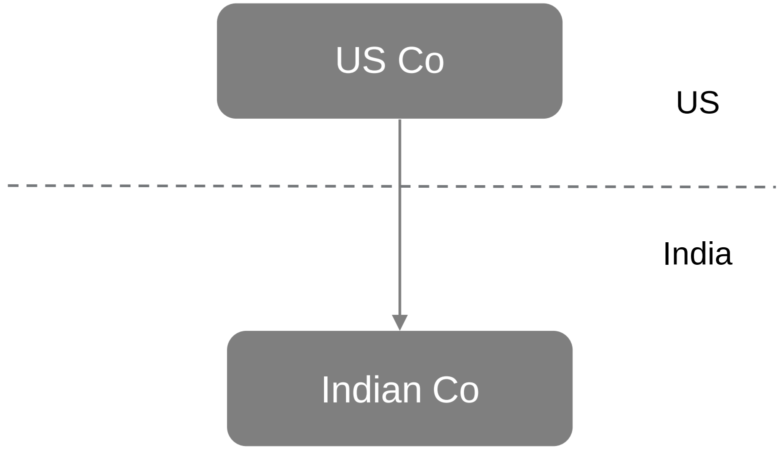
Case study 3 - No FTS Article under DTAA

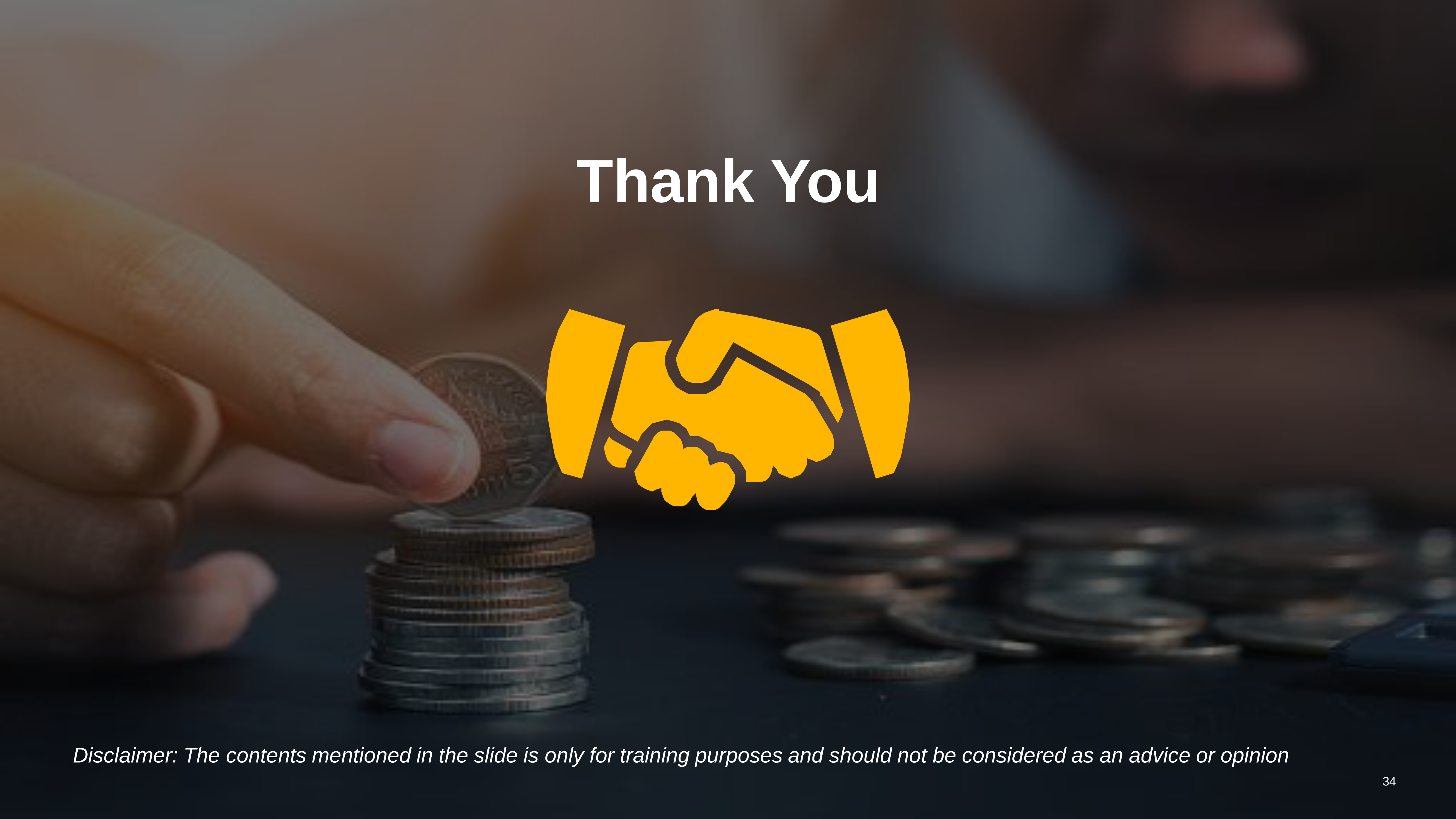
- Thailand company entered into technical assistance know-how agreement with MBDL, in India for transfer of glass technology know-how.
- The assessee received technical know-how fees for five years.
- In the absence of FTS provisions under India-Thailand DTAA, MBDL would like to understand whether the same will be characterized as Business Income (or) Other Income ??



Case study 4 - Interpretation of Make Available

- An Indian firm owns inventory control software for use in its chain of retail outlets throughout India.
- It expands its sales operation by employing a team of traveling salesmen to travel around the countryside selling the company's wares.
- The company wants to modify its software to permit the salesmen to access the company's central computers for information on what products are available in inventory and when they can be delivered.
- The Indian firm hires a U.S. computer programming firm to modify its software for this purpose.
- Are the fees which the Indian firm pays treated as fees for included services?





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